



All Cap Index & Sectors: 1Q23 GAAP Earnings Growth is An Illusion (Free, Abridged)

Trailing-twelve-months (TTM) [Core Earnings](#) fell 1% quarter-over-quarter (QoQ), while TTM GAAP Earnings rose 3% QoQ in 1Q23. Seeing GAAP Earnings rise while Core Earnings decline reminds us of the more stable nature of Core Earnings. Because our data removes unusual gains and losses, Core Earnings are not prone to the large swings seen in GAAP Earnings.

This report is an abridged and free version of [All Cap Index & Sectors: 1Q23 GAAP Earnings Growth is An Illusion](#), one of our quarterly reports on [fundamental market and sector trends](#).

The full version of the report analyzes [Core Earnings](#)¹² and GAAP earnings of the NC 2000 and each of its sectors (last quarter's analysis is [here](#)). The full reports are available to [Professional](#) and [Institutional](#) members.

This report leverages our cutting-edge [Robo-Analyst technology](#) to deliver [proven-superior](#) fundamental research and support more cost-effective fulfillment of the [fiduciary duty of care](#).

[Buy the Full Version of This Report](#)

GAAP Earnings Illusory Growth in 1Q23

Our superior fundamental data protects investors from being misled by false trends in un-scrubbed GAAP Earnings. The recent rise in GAAP Earnings explains part of Wall Street's recent bullishness and our bearishness on certain stocks. Looking beyond the headlines reveals that the rise in GAAP Earnings may be an illusion for two reasons:

1. it is more of a result of an exaggerated slump in the prior quarters. The kitchen sink effect in full effect.
2. Core Earnings are heading lower now, therefore GAAP Earnings are not likely to continue their rise.

If the rise in GAAP Earnings proves to be an illusion, investors could be in for a rude awakening if they've been investing in expensive stocks. See Figure 1 in the [full report](#).

Core Earnings Are Less Volatile than GAAP Earnings

Corporate profits, as measured by Core Earnings, have been much less volatile than GAAP earnings suggest, especially since 1Q20. For example, per Figure 1, in the TTM ended:

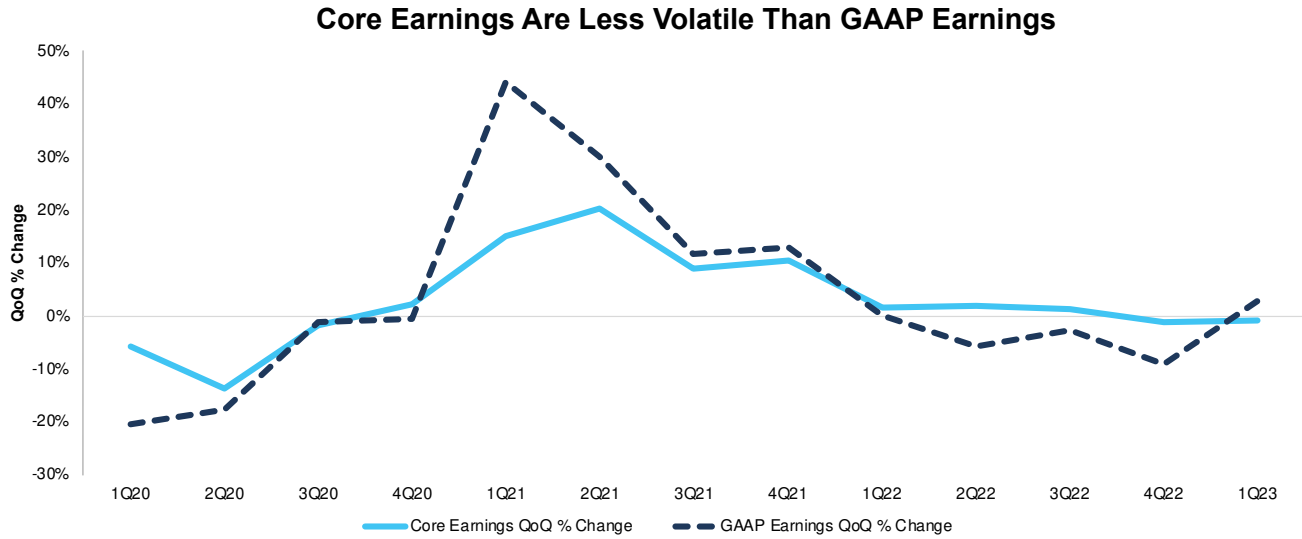
- 1Q21, GAAP earnings rose 44% QoQ compared to a 15% rise in Core Earnings.
- 2Q22, GAAP earnings fell 6% QoQ compared to a 2% rise in Core Earnings.
- 3Q22, GAAP earnings fell 3% QoQ compared to a 1% rise for Core Earnings.
- 4Q22, GAAP earnings fell 9% QoQ compared to a 1% decline for Core Earnings.
- 1Q23, GAAP earnings rose 3% QoQ compared to a 1% decline for Core Earnings.

¹ Core Earnings enable investors to overcome the flaws in legacy fundamental data and research, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan for [The Journal of Financial Economics](#).

² Based on the latest audited financial data, which is the 1Q23 10-Q in most cases. Price data as of 5/15/23.



Figure 1: NC 2000 Core Earnings Vs. GAAP Earnings QoQ Percent Change: 1Q20 – 1Q23



Sources: New Constructs, LLC and company filings.
 Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.
 The May 15, 2023 measurement period incorporates the financial data from calendar 1Q23 10-Qs, as this is the earliest date for which all of the calendar 1Q23 10-Qs for the NC 2000 constituents were available.

GAAP Earnings Understate Core Earnings for Nearly Two-Thirds of the NC 2000 (by Market Cap)

For the TTM ended 1Q23, 62% of the companies in the NC 2000 reported GAAP Earnings that are lower than Core Earnings. The 1,242 companies with understated GAAP earnings make up 63% of the market cap of the NC 2000 as of 5/15/23.

When GAAP Earnings are lower than Core Earnings, they are understated by an average of 102%, per Figure 2. GAAP Earnings understated Core Earnings for 1,242 companies in 1Q23, compared to 1,283 in the TTM ended 4Q22.

Figure 2: NC 2000 GAAP Earnings Understated by 102% On Average

Understated GAAP Earnings	Understated by >10%	Average Understatement %
1,242 companies	686 companies	102%

Sources: New Constructs, LLC and company filings.
 We use Funds from Operations (FFO) for Real Estate companies rather than GAAP Earnings.

Key Details on Select NC 2000 Sectors

The Energy sector saw the largest QoQ improvement in Core Earnings, which rose from \$285.7 billion in 4Q22 to \$304.3 billion in 1Q23, or 7%.

At \$445.3 billion, the Technology sector generates the highest Core Earnings, and saw Core Earnings fall 2% QoQ in 1Q23. On the flip side, the Real Estate sector has the lowest Core Earnings at \$28.4 billion, and had the largest QoQ decline in 1Q23 at -14%.

Below we highlight the Consumer Cyclical sector and a stock with some of the most negative Earnings Distortion (i.e. understated GAAP earnings) in the sector.

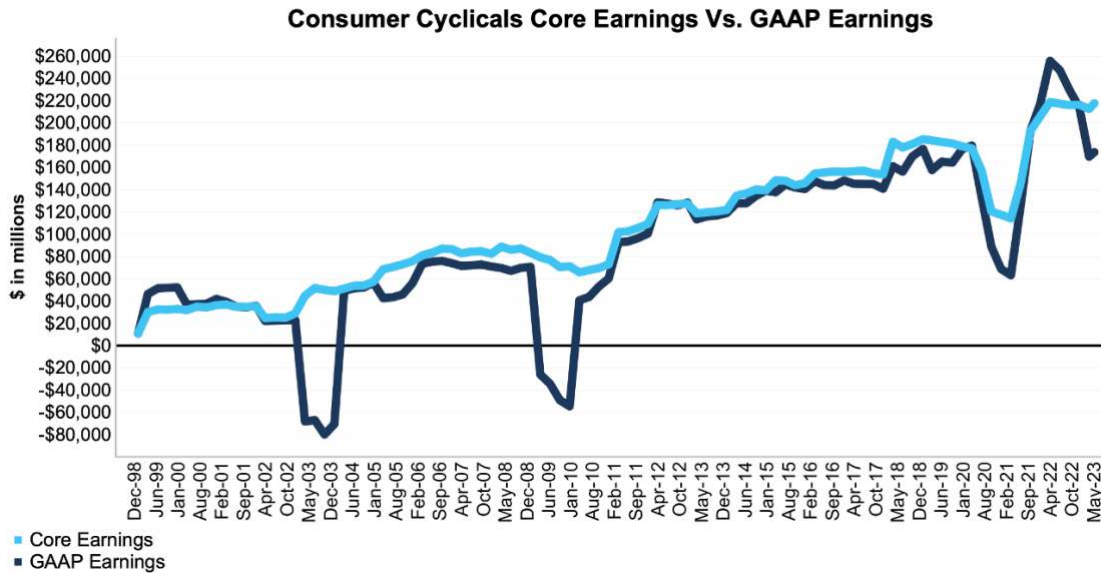
Sample Sector Analysis³: Consumer Cyclical Sector

Figure 3 shows Core Earnings for the Consumer Cyclical sector, at \$217.9 billion, rose 2% QoQ in 1Q23, while GAAP earnings, at \$173.9 billion, rose 2% over the same time.

³ The full version of this report provides analyses for all eleven sectors.



Figure 3: Consumer Cyclical Core Earnings Vs. GAAP: 1998 – 1Q23



Sources: New Constructs, LLC and company filings.
 Our Core Earnings analysis is based on aggregated TTM data for the sector constituents in each measurement period.
 The May 15, 2023 measurement period incorporates the financial data from calendar 1Q23 10-Qs, as this is the earliest date for which all of the calendar 1Q23 10-Qs for the NC 2000 constituents were available.

GAAP Earnings Understatement Details: General Motors (GM)

Below, we detail the [hidden and reported](#) unusual items overlooked in GAAP Earnings and captured in Core Earnings for General Motors (GM). After adjusting for unusual items, we find that General Motors’ Core Earnings of \$11.6 billion, or \$8.08/share are much higher than reported GAAP Earnings of \$9.3 billion, or \$6.47/share.

General Motors’ [Earnings Distortion Score](#) is Beat and its Stock Rating is Very Attractive, in part due to its positive [economic earnings](#), high free cash flow yield, and low price-to-economic book value ([PEBV](#)) ratio of 0.4. We made General Motors a Long Idea in [March 2018](#). and while the stock has underperformed, it remains highly undervalued. See all our research on General Motors [here](#).

Below, we detail the differences between Core Earnings and GAAP Earnings so readers can audit our research.

Figure 4: General Motors’ GAAP Earnings to Core Earnings Reconciliation: TTM through 1Q23

	TTM (\$ per share)
GAAP Net Income	\$6.47
– Hidden Unusual Expenses, Net	(\$1.50)
– Reported Unusual Expenses Pre-Tax, Net	(\$0.30)
– Tax Distortion	\$0.19
= Core Earnings	\$8.08

Sources: New Constructs, LLC and company filings.

More details:

Total Earnings Distortion of -\$1.61/share, which equals -\$2.3 billion, is comprised of the following:

Hidden Unusual Expenses Pre-Tax, Net = -\$1.50/per share, which equals -\$2.2 billion and is comprised of:

- -\$1.4 billion in hidden restructuring expenses in the TTM period based on
 - [-\\$875 million](#) in voluntary separation program charges on page 26 in 1Q23 10-Q
 - [-\\$99 million](#) in Buick dealer strategy charges on page 26 in 1Q23 10-Q
 - [-\\$383 million](#) in restructuring and other initiatives in the TTM based on [\\$511 million](#) charge on page 90 in the 2022 10-K



- -\$1 million impairment charges in 4Q22 based on [-\\$12 million](#) impairment charge on page 72 in 2022 10-K
- [-\\$11 million](#) impairment charge on page 25 in 2Q22 10-Q
- -\$793 million in cruise compensation modifications based on [-\\$1.1 billion](#) charge on page 27 in the 2022 10-K

Reported Unusual Expenses Pre-Tax, Net = -\$0.30/per share, which equals \$431 million and is comprised of:

- [-\\$542 million](#) in other expenses in the 2022 10-K
- \$1.4 billion in interest and other non-operating income in the TTM period based on
 - [\\$409 million](#) in 1Q23
 - [\\$102 million](#) in 4Q22
 - [\\$598 million](#) in 3Q22
 - [\\$295 million](#) in 2Q22
- [\\$238 million](#) in licensing agreements income in 2022 10-K
- [-\\$236 million](#) in revaluation of investments in 2022 10-K
- \$1.3 billion contra adjustment for [recurring pension costs](#). These recurring expenses are reported in non-recurring line items, so we add them back and exclude them from Earnings Distortion.

[Tax Distortion](#) = \$0.19/per share, which equals \$278 million.

This article was originally published on [June 7, 2023](#).

Disclosure: David Trainer, Kyle Guske II, and Italo Mendonça receive no compensation to write about any specific stock, style, or theme.

Questions on this report or others? Join our [Society of Intelligent Investors](#) and connect with us directly.



Appendix: Calculation Methodology

We derive the Core Earnings and GAAP Earnings metrics above by summing up the trailing-twelve-month individual NC 2000 constituent values for Core Earnings and GAAP Earnings in each sector for each measurement period. We call this approach the “Aggregate” methodology.

The Aggregate methodology provides a straightforward look at the entire sector, regardless of market cap or index weighting and matches how S&P Global (SPGI) calculates metrics for the S&P 500.



It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our “novel database” enables investors to overcome these flaws and apply [reliable](#) fundamental data in their research.
3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms’ data collection processes to provide superior [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global’s (SPGI) Adjustments* individually.” – pp. 14, 1st para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5th para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3rd para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are [here](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs.

Copyright New Constructs, LLC 2003 through the present date. All rights reserved.